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SUBJECT: NATIONAL ASSEMBLY PASSES FY09-10 BUDGET

REF: ISLAMABAD 1355

¶1. (SBU) Summary: The GOP presented its budget to Parliament on June 13 (reftel). After a week of debate, on June 22 the GOP presented a revised budget which reflected revisions desired by members. This budget was passed unanimously by Parliament with no changes on June 25. While the overall parameters of the budget remained the same - the budget deficit of 4.9 percent, and revenue and expenditure targets - additional outlays on such items as higher civil service wage increases and lower withholding taxes on imports will most likely be financed by a decrease in development spending. The country representatives of the Asian Development Bank and the International Monetary Fund, along with many other economists, voiced concerns that the GOP's revenue projections were optimistic and that their expenditures were underestimated, which would lead ultimately to a substantially larger budget deficit. End Summary

¶2. (SBU) After a week of Parliamentary debate, the GOP presented a revised budget on June 22, which reflected the wishes of the National Assembly members. There were several major changes: a 20 percent rather than a 15 percent salary increase for lower grade civil servants; the withholding tax on imports for the industrial sector reduced from a proposed 4 percent to 3 percent; and compressed natural gas (CNG) exempted from the carbon surcharge. The Parliament also introduced some changes in the customs duties and excise taxes on a wide variety of raw materials meant to revive certain industrial sectors. The major parameters of the budget, however, did not change. The total budget was still \$36.21 billion, the total tax collection target remained at \$17.5 billion, and the budget deficit was still 4.9 percent of GDP. On July 25, the Parliament unanimously adopted this budget with no change.

¶3. (SBU) According to the Ministry of Finance, the latest revisions will cost between \$375 million and \$437 million. The World Bank, on the other hand, estimates they will total between \$500 and \$625 million: salary increases will cost an additional \$250 million; lower withholding taxes will cost \$125-\$137 million in lost revenue; and dropping the tax on CNG will forfeit \$150 million of projected revenue. MOF sources say that some of the losses can be made up through more stringent tax collection and that the new tax on real estate transactions has a much greater potential than projected in the budget. However, most experts believe that the GOP will make up the difference by cutting development expenditures, which were increased by 54 percent this year.

¶4. (SBU) More generally, experts have voiced concern that both the original and final versions of the budget have underestimated expenditures and overstated revenues. For example, the World Bank told us that a more realistic estimate for the original salary

increases would have been \$200-250 million, rather than the budgeted \$100 million. The IMF resident representative gave the example that revenue estimates from the State Bank of Pakistan were considerably overstated. In a June 19 roundtable on the budget with major donors, the Asian Development Bank [protect] was particularly critical of the GOP's inability to increase its tax receipts, noting that revenue receipts, net of transfers to the provinces, were not sufficient to pay for the government's current expenditures. It had expected something closer to 1 percent of GDP in new tax measures, whereas the current budget had initiated only 0.3-0.4 percent of GDP. The ADB also expressed disappointment that the budget undertook no forward leaning, long-range reforms.

¶15. (SBU) Comment: The budget presented on June 13 is regarded as risky and likely to run into challenges as the year progresses, given its narrow revenue base and dependency on foreign assistance flows. The revised budget, which contains roughly \$400-600 million in additional outlays/tax reductions, will be even more so. While these changes are unfortunate, they reflect the political reality here and do not in themselves presage a collapse of the IMF Stand-By Arrangement, but rather the perennial trade-off between special interests and development spending.

PATTERSON